

Honorable Marc L. Barreca  
Chapter 11 Sub V  
Hearing Date: February 22, 2024  
Hearing Time: 9:30 a.m.  
Location: Seattle, WA  
Response Date: February 15, 2024

**IN THE UNITED STATES BANKRUPTCY COURT FOR THE  
WESTERN DISTRICT OF WASHINGTON**

In re:

Case No. 23-11919

HWC BURBS BURGERS, LLC,

Debtor.

**UNITED STATES TRUSTEE'S  
MOTION TO CONVERT OR  
DISMISS CHAPTER 11 CASE FOR  
INCURRING A SUBSTANTIAL OR  
CONTINUING LOSS TO THE  
ESTATE AND THE ABSENCE OF A  
REASONABLE LIKELIHOOD OF  
REHABILITATION; GROSS  
MISMANAGEMENT; FAILURE TO  
PROVIDE INFORMATION  
REASONABLY REQUESTED BY  
THE U.S. TRUSTEE; AND FAILURE  
TO TIMELY PAY TAXES**

Acting United States Trustee for Region 18, Gregory M. Garvin ("U.S. Trustee"), hereby moves the Court for an order converting or dismissing the above-entitled chapter 11 case. Since this case was filed in October of 2023, Debtor failed to pay his tax obligations to the State of Washington, has bounced numerous checks resulting in unpaid post-petition liabilities, made payments to vendors for pre-petition liabilities, failed to file its monthly operating reports on time, failed to provide the U.S. Trustee with information he requested regarding payments to the pre-petition vendors, and failed to provide information regarding wire transfers from Debtor's bank account. Further, while taxes and post-petition obligations have gone unpaid, Debtor's

UNITED STATES TRUSTEE'S MOTION TO  
CONVERT OR DISMISS CHAPTER 11 CASE

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principal has taken draws in excess of the draws approved by the cash collateral budget. In support of the Motion, the U.S. Trustee represents and alleges as follows:

1. The Court has jurisdiction over the Motion pursuant to 11 U.S.C. §§ 307 and 1112(b).

2. The U.S. Trustee brings the Motion under the U.S. Trustee's authority to supervise the administration of bankruptcy cases under 28 U.S.C. § 586(a)(3) and 11 U.S.C. § 1112(b)(1).

### **I. BACKGROUND**

HWC Burbs Burgers, LLC, filed a petition for relief under Title 11, chapter 11, subchapter V, on October 9, 2023 (the "Petition Date"). Michael DeLeo was appointed as the subchapter V trustee on October 11, 2023. The first meeting of creditors was held on November 14, 2023, (the "341 Meeting"), and the status conference required by 11 U.S.C. § 1188(a) was held on December 16, 2023.

Debtor has a history of filing its monthly operating reports ("MORs") late, and the reports appear to be inaccurate. Debtor filed its November MOR, which was due December 20, 2023, on January 5, 2024. Based on that MOR, Debtor bounced forty-four checks, totaling \$95,723.12. ECF #54, pgs. 14-24. Further, on January 22, 2024, the State of Washington Department of Revenue filed an "Amended Administrative Expense Claim for Post Petition Taxes Due," according to which Debtor owes \$42,969.75 for sales tax, business tax, and penalties for October of 2023, and \$39,302.11 for sales tax, business tax, and penalties for November of 2023. ECF #59. Although Debtor owed approximately \$180,000.00 in post-petition debts at the end of November, Debtor reported \$0.00 in unpaid bills on the November MOR. ECF #54, pg. 3.

Furthermore, despite not paying post-petition taxes and other liabilities, Debtor's managing member has continued to withdraw more cash than he was approved to withdraw in the

1 cash collateral budget. On December 14, 2023, the Court entered a belated order authorizing  
2 Debtor to use cash collateral to pay post-petition expenses as set forth in Exhibit “B” of the  
3 Declaration of Joshua Henderson. ECF #46. The cash collateral budget is located on the Court’s  
4 docket at ECF 14-2 (the “Cash Collateral Budget”). Pursuant to the Cash Collateral Budget,  
5 Debtor was authorized an “Officer Salary” of \$3,500.00 per week (\$15,166.66 per month on  
6 average) beginning October 29, of 2023. *Id.* However, Debtor’s principal took draws totaling  
7 \$24,251.99 in November 2023, (ECF #54, pg. 5.) and \$23,000.00 in October of 2023, ECF # 53,  
8 pg. 5.

9  
10 The Debtor has also failed to supply requested financial information that is necessary to  
11 the administration of this case, including:

- 12 (1) Documentation regarding payments to vendors that were made post-petition for pre-  
13 petition debts;
- 14 (2) Documentation concerning multiple wire transfers from Debtor’s bank account both  
15 before and after filing; and
- 16 (3) An unredacted copy of the October 2023 bank statement.

17 *See* Declaration of Matthew J.P. Johnson (herein “Johnson Declaration”).

18 Moreover, as of the date of this Motion, Debtor is overdue on its December 2023 MOR,  
19 which was due on January 20, 2024. The U.S. Trustee cannot evaluate whether confirmation is  
20 appropriate without the requested documents.

21  
22 **II. ANALYSIS**

23 Conversion to chapter 7 is likely in the best interest of creditors in this case due to the wire  
24 transfers and lack of clear information. Section 1112(b) provides that, “the court shall convert a  
case under this chapter to a case under chapter 7 or dismiss a case under this chapter, whichever

1 is in the best interest of creditors and the estate, for cause unless the court determines that the  
2 appointment under section 1104(a) of a trustee or an examiner is in the best interests of creditors  
3 and the estate.”

4 In a chapter 11 case, cause includes, “substantial or continuing loss to or diminution of  
5 the estate and the absence of a reasonable likelihood of rehabilitation under § 1112(b)(4)(A);  
6 gross mismanagement of the estate under § 1112(b)(4)(B); the failure timely to provide  
7 information...reasonably requested by the United States trustee under § 1112(b)(4)(H); and  
8 failure timely to pay taxes owed after the date of the order for relief under § 1112(b)(4)(I).

9  
10 A. Substantial or Continuing Loss and an Absence of a Reasonable Likelihood of  
Reorganization.

11 Debtor has caused a substantial loss to the estate and such loss appears to be continuing.  
12 Courts have established a two-pronged test for examining dismissal under § 1104(b)(4)(A). The  
13 first prong “is demonstrated by a loss that will ‘materially negatively impact the bankruptcy estate  
14 and the interest of creditors,’ or ‘dwindling liquidity, or illiquidity resulting in unpaid postpetition  
15 debts which usually constitute administrative expenses that will take priority over prepetition  
16 claims.’” *Hassen Imps. P'ship v. City of W. Covina (In re Hassen Imps. P'ship)*, WL 4428508, pg.  
17 13. (B.A.P. 9th Cir. Aug. 19, 2013) (citing 7 Collier on Bankruptcy at ¶ 1112.04[6][a][i]).  
18

19 The Debtor meets the first prong because he has incurred substantial debts that will take  
20 priority over pre-petition claims. Second in priority under § 507(a)(2) are administrative expenses  
21 allowed under § 503(b). The administrative expenses include “any tax – incurred by the  
22 estate...and any fine, penalty, or reduction in credit relating to [such] tax.” § 503(b)(1)(B) & (C).  
23 As noted above, the State of Washington Department of Revenue has filed a request for payment  
24 in the amount of \$82,271.86 for post-petition sales tax, B&O tax, and related fines and penalties.

The holders of the returned checks likely also have claims against the estate that would take

1 priority over pre-petition creditors.

2 This case also meets the second prong of the test because it will be difficult for Debtor to  
3 repay the post-petition debt. The second prong “requires the bankruptcy court to determine  
4 whether the continuing losses can be corrected and whether Debtor is capable of rehabilitation.”  
5 *Legal Serv. Bureau, Inc. v. Orange Cty. Bail Bonds, Inc. (In re Orange Cty. Bail Bonds, Inc.)*,  
6 638 B.R. 137, 150 (B.A.P. 9th Cir. 2022) (citing 7 Collier On Bankruptcy ¶ 1112.04 [6][a][ii]  
7 (Alan N. Resnick & Henry J. Sommer, eds. 16th ed. rev. 2021)). As a result of Debtor’s conduct,  
8 there is substantial post-petition debt which will need to be repaid, and debtor has not shown that  
9 it can operate profitably even while under bankruptcy protection. Further, reorganization may be  
10 impossible with current management, which has prioritized his income to payments of creditors.  
11

12 B. Gross Mismanagement

13 A variety of conduct can establish gross mismanagement. *In re Ozcelebi*, 639 B.R. 365,  
14 388-89 (Bankr. S.D. Tex. 2022). Grounds for dismissal may include “use of estate funds to pay  
15 insiders, pre-petition unsecured creditors, and professionals.” *Id.* at 389. Additionally, “over  
16 drafting a DIP account tends to indicate mismanagement.” *Id.* at 390. As does, “inadequate  
17 financial reporting.” *Id.* at 391. While one of these issues in a case alone may not be considered  
18 gross mismanagement, the Debtor in this case has all of these issues. Debtor has bounced over  
19 forty checks due to repeated overdrafts of the bank account; owes a substantial amount of post-  
20 petition taxes; has paid pre-petition debts to his vendors, all while the managing member  
21 continues to draw over \$20,000.00 per month from the bank account.  
22

23 At the same time, Debtor has obscured its finances. Debtor list \$0.00 in post-petition  
24 liabilities despite the bounced checks and failure to pay post-petition taxes. Debtor has also failed  
to file MORs when due and has failed to provide the U.S. Trustee with requested documents

1 regarding the Debtor's financial condition. As a result of this combination of factors, the Debtor-  
2 in-Possession should no longer be trusted to operate the business.

3 C. Failure Timely to Provide Information Requested by the United States Trustee.

4 Debtor has failed to provide information that is critical to the oversight of this case. Cause  
5 for dismissal includes a debtor's "failure timely to provide information or attend meetings  
6 reasonably requested by the United States trustee." § 1112(b)(4)(H). "A chapter 11 debtor's  
7 cooperation is critical to maintain the integrity of the reorganization process. The debtor's  
8 financial disclosures, schedules, and monthly operating reports are 'more than mere busy work.'" *In re McKenna*, 580 B.R. 1, 13 (Bankr. D.R.I. 2017) (citing *Andover Covered Bridge, LLC*, 553  
9 B.R. 162, 173 (BAP 1<sup>st</sup> Cir. 2016)). Without these reports, the [U.S. Trustee] and creditors cannot  
10 determine when a debtor is incurring additional losses, is rendered administratively insolvent, or  
11 is transferring assets without authorization." *Andover Covered Bridge, LLC*, 553 B.R. at 173  
12 (citing *In re Whetten*, 473 B.R. 380, 383 (Bankr. D.CO 2012)).

13 Debtor has not filed the December monthly operating reports, and both the October and  
14 November reports were filed late. Furthermore, the U.S. Trustee has made multiple requests for  
15 information regarding post-petition payments to pre-petition creditors and information regarding  
16 the recipients of various wire transfers. The monthly operating reports and other requested  
17 information is necessary to allow the U.S. Trustee to evaluate the case.

18 D. Failure to Pay Post-Petition Taxes

19 Debtor's case should also be dismissed or converted due to its failure to pay post-petition  
20 taxes. Cause includes a debtor's "failure to timely pay taxes owed after the petition date." §  
21 1112(b)(4)(I). As noted above, Debtor has not paid B&O tax and has failed to remit sales tax to  
22 the state of Washington. As a result, this case should either be dismissed or converted.

1 E. Conversion vs. Dismissal

2 If the moving party meets its burden under § 1112, the court must “apply a ‘balancing  
3 test’ to choose between conversion or dismissal based upon the ‘best interests of the creditors and  
4 the estate.’” *In re AVI, Inc.*, 389 B.R. 721, 729 (B.A.P. 9th Cir. 2008), citing *In re Nelson*, 343  
5 B.R. 671, 675 (B.A.P. 9th Cir. 2006); see also *In re Owens*, 552 F.3d 958, 960-61 (9th Cir. 2009)  
6 (court must consider interests of all creditors). In the present case, there are likely post-petition  
7 transfers that could be recovered and the business itself may have value if sold or liquidated.

8 The U.S. Trustee is not aware of any “unusual circumstances” that should prevent  
9 converting or dismissing the chapter 11 case. Generally, a court may not dismiss or convert a  
10 case, under than under § 1112(a)(4)(A), if it finds “unusual circumstances establishing that  
11 converting or dismissing the case is not in the best interest of creditors.” 11 U.S.C. § 1112(b)(2).  
12 Given the lack of such circumstances, the Court should either convert this case to a case under  
13 chapter 7 or dismiss the case.

14 WHEREFORE, the U.S. Trustee respectfully requests that the Court enter its Order  
15 converting this case to a case under chapter 7, or dismissing it, whichever the Court determines  
16 to be in the best interest of creditors.  
17

18 DATED this Tuesday, January 30, 2024,  
19

20 Respectfully submitted,

21 Gregory M. Garvin  
22 Acting U.S. Trustee for Region 18

23 /s/ Matthew J.P. Johnson  
24 Matthew J.P. Johnson, WSBA #40476  
Attorney for the United States Trustee